

BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of the Nebraska Public Service)	Application No. NUSF-50
Commission, on its Own Motion, to Make)	
Adjustments to the Universal Service Fund)	Progression Order No. 1
Mechanism Established in NUSF-26.)	

COMMENTS OF
CITIZENS TELECOMMUNICATIONS COMPANY OF NEBRASKA
d/b/a FRONTIER COMMUNICATIONS OF NEBRASKA

Citizens Telecommunications Company of Nebraska, d/b/a Frontier Communications of Nebraska (“Frontier”) appreciates the opportunity to comment on issues raised by the Nebraska Public Service Commission (“Commission”) in Progression Order #1, Application No. NUSF-50. This Order, issued by the Commission on January 18, 2006 (“January 18th Order”), sought input on the possible modification of the Nebraska Universal Service Fund (“NUSF”) mechanism in light of the Commission’s decision to reduce the NUSF surcharge from 6.95 percent to 5.75 percent of intrastate retail revenues on telecommunications services.

In this filing, Frontier will comment on several of the issues and questions posed by the Commission in the January 18th Order.

I. INTRODUCTION

The Commission is faced with the difficult prospect of making reductions in the level of NUSF support received by several and, more likely, all recipient companies. These funds have played an important role in supporting the deployment and maintenance of telecommunications infrastructure throughout Nebraska. It has helped assure that customers statewide have access to the latest in high quality services at reasonable rates. With rising operating costs and flat or negative access line growth, a longer-term replacement of lost NUSF funding will be needed to support continued investment in rural areas.

Frontier finds it difficult to definitively advocate a specific course of action in its initial comments for two reasons. First, while the January 18th Order implies there is a \$7.5 million shortfall between the NUSF base support allocation of \$66.5 million and the \$74 million current level of distribution, the size of the longer-term funding deficiency is unknown but should be considered in this proceeding. Second, it is difficult to advocate a particular modification to the funding mechanism without quantifying the impact various changes may have on the overall fund. It is for that reason Frontier believes a major means of balancing available funds with distributed support should be a proportional across-the-board reduction in funding for all companies. Without such a mechanism, Frontier is concerned that the Commission will routinely need to tinker with the support mechanism over time to balance the fund.

The Commission suggests several possible changes to the NUSF mechanism. Frontier's concern with selecting any one or a combination of these remedies is that it may never produce the intended result or may produce the intended result in only the first year. For example, comment is sought on modifying the manner in which earnings are calculated. The Commission may be able to select a set of modifications to the earnings calculation which balances the fund when applied historically but that remedy may not produce the same result when applied prospectively. This could necessitate an on-going modification of the mechanism to balance funding receipts with disbursements. In contrast, an across-the-board reduction in funding for all carriers receiving NUSF support both assures the fund can be balanced annually and would be the most fair and balanced approach. All companies would "share in the pain" equally.

II. MODIFICATION OF THE TRANSITIONAL SUPPORT MECHANISM

Before any other modifications to the support mechanism are implemented, the Commission should first shorten the transitional support mechanism to more rapidly bring

companies to the level of “need” determined under the mechanism established in NUSF-26. In NUSF-26 the Commission adopted a five-year transition period for the Per-Line Backstop and the Over-Earnings Redistribution. NUSF-26 Order at para. 62 (November 3, 2004). The Commission also continued to make NUSF-7 support available on a transitional basis until the investments made by the company were fully depreciated. Under the NUSF-26 Order, the Per-Line Backstop and Over-Earnings Redistribution are to remain in effect until January 2010.

While the transition mechanism is good intentioned in that it softens the impact of the change in support mechanisms, it does provide support over and above the level of “need” as determined by the Commission in NUSF-26. Frontier questions why a transition period from the interim NUSF mechanism to a permanent NUSF mechanism should take longer than two or three years. This is especially true given that the interim NUSF mechanism was only in place for approximately four years. Given the shortage of funds available to meet current needs, a reduction in the transition period should be the first adjustment made to help bring the fund into balance. It is recommended that no change in the transition mechanism be implemented in 2006 to minimize the immediate impact on transitioning companies but that the transition mechanism be eliminated beginning with funding paid in 2007.

III. INCREASE IN BENCHMARK RATE

Frontier believes that Nebraska companies, including itself, will do their best to continue to strive to maintain service quality and reliable service in the face of declining NUSF support. As funding declines, however, investment in new infrastructure will be curtailed for certain network upgrades such as: 1) projects to shorten loop lengths; 2) increasing bit rates for digital services; and 3) upgrades to support extension of high-speed Internet offerings further into rural areas of our exchanges. Depending upon the magnitude and duration of support reductions,

infrastructure investment could decline unless companies are permitted to otherwise offset those losses. One such alternative for partially offsetting funding loss is an increase in the statewide benchmark local residential rate.

The Commission has established \$17.50 per month as a rate benchmark for residential basic local exchange service. In order to qualify for support an eligible telecommunications provider is required to price its residential service above \$17.50. As a second modification to the funding mechanism, Frontier supports an increase in the statewide benchmark rate from \$17.50 to \$18.50. Increasing the benchmark rate would raise the earnings of carriers receiving NUSF funding and thus reduce the NUSF funding requirement. In addition, the increased benchmark would provide companies with the ability to recover a portion of the lost NUSF funding through increase rates. All companies should be required to impute the increased benchmark rate as a direct reduction to NUSF funding concurrent with the effective date of the increase in the benchmark rate. This change produces an impact on the overall funding requirement that is reliably quantifiable while providing companies with an alternative source of recovering lost funding to minimize any impact on future capital expenditures.

As the second priority for change in the funding mechanism, Frontier recommends an increase in the benchmark rate from \$17.50 to \$18.50. Again, in order to minimize disrupting 2006 funding, the Commission should implement the increased residential benchmark rate beginning January 1, 2007.

IV. CHANGE IN RATE OF RETURN

The Commission is seeking comment on whether it should reduce the rate of return for carriers from 12 % to 10 or 8 %. Companies whose earnings exceed the Commission's established rate of return benchmark of 8 or 10% would be ineligible for NUSF support.

Frontier has the following concerns associated with implementing a reduced rate of return to determine NUSF eligibility: 1) a rate of return earning reduction discourages carrier efforts to improve efficiency; 2) reduction in the rate of return may adversely impact investment in Nebraska; 3) a reduction in the rate of return earning levels may not generate predictable reductions in the NUSF payouts; and 4) the Commission has other alternatives to an earnings test to ensure investments are made in Nebraska.

First, the Commission should be careful to maintain incentives for companies to be more efficient and reduce their costs. Companies operating in Nebraska should not be penalized in terms of disqualification from the NUSF mechanism simply because they are successful in increasing their efficiency and decreasing their expenses, which results in increased earnings. The Commission should not reduce NUSF funding to an efficient low-cost provider while rewarding an inefficient higher-cost carrier with no reduction in NUSF funding.

Second, because the existing earnings test is based on embedded investments and costs, it does not evaluate new investment in Nebraska. Based on historical investments and current depreciation, a company's earnings may be below the 8 or 10% earning threshold, even though the company has made little or no current or recent year investments. Conversely, a company that has made sizable new investments in Nebraska may exceed the earnings cap threshold because of extended depreciation lives for the investment and thereby remain disqualified from NUSF support. In addition, investments flow to areas where they can achieve the highest rate of return. A reduction in the rate of return recognized by the Commission could directly discourage infrastructure investment in the state.

Third, a reduction in the rate of return to 10% or 8% may reduce the payout on the NUSF when applied historically but may not produce the same result when applied prospectively.

With rising operating costs and flat or negative access line growth, still further reductions in the NUSF rate of return may be needed to balance funding and payouts in future years. This could necessitate an on-going modification of the rate of return or other mechanisms to balance funding receipts with disbursements.

Finally, the Commission has other alternatives to reducing the rate of return. As Frontier described above, the Commission has the option to change the transition period from the interim to permanent NUSF mechanism and the option to increase the residential benchmark rate to offset deficiencies in NUSF funding. In addition, as explained below, an across-the-board reduction NUSF funding for all carriers receiving funding both assures the fund can be balanced annually and would be the most fair and balanced approach.

V. ACROSS-THE-BOARD REDUCTION IN FUNDING

Frontier believes the funding mechanism should be structured so that, in addition to any other funding mechanism changes the Commission may establish in this proceeding, any anticipated reduction in funding shortfall in the foreseeable future can be balanced through a proportional or across-the-board reduction in funding. This will assure that there is always a rational and efficient adjustment mechanism in-place for bringing the fund into balance on an annual basis.

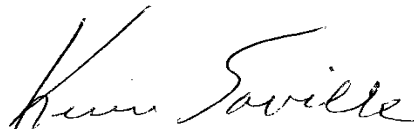
Specifically, Frontier suggests the Commission adopt a proportional, “across-the-board” reduction in the level of support paid to companies sufficient to balance the fund on an annual basis. If, after other funding mechanism changes are implemented, there is an X percent projected level of funds, the level of funding calculated after the other adjustments, would be reduced by X percent for all companies receiving NUSF funding. This action could be taken by the Commission in late 2006 based on projected NUSF funding in 2007 and be implemented

with the first NUSF funding payments in 2007. This annual adjustment would ensure that the fund is in balance on an on-going basis without the need to annually modify other components of the funding mechanism. This approach also ensures all companies are impacted proportionately.

VI. CONCLUSION

Unfortunately, it appears that “no change” in the current NUSF funding mechanism is not an option. Frontier offers, in order of priority, its recommended changes: 1) shorten the transition period between the interim and permanent NUSF mechanism; 2) increase the residential benchmark rate to \$18.50 and impute the higher rate to all carriers; and 3) implement an across-the-board reduction in funding which is consistent for all companies. Perhaps not all changes will be needed to bring the NUSF fund into balance but Frontier recommends that the “across-the-board” reduction change be among those employed to assure the funding mechanism does not require further modification for the foreseeable future.

Respectfully submitted this 22nd day of March, 2006.

A handwritten signature in black ink, reading "Kevin Saville". The signature is fluid and cursive, with the first name "Kevin" and last name "Saville" clearly distinguishable.

Kevin Saville
Associate General Counsel
Frontier Communications
2378 Wilshire Blvd.
Mound, MN 55364
(952) 491-5564 Telephone
(952) 491-5577 Facsimile
ksaville@czn.com